

IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

PEPSICO, INC. AND AFFILIATES,)	
)	Case Nos. 16 TT 82 and 17 TT 16
Petitioner,)	
)	
v.)	
)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE,)	
)	
Respondent.)	

**PETITIONER PEPSICO, INC. AND AFFILIATES' MEMORANDUM
IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT
FOR REASONABLE CAUSE PENALTY ABATEMENT**

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Date: March 17, 2022

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SUMMARY OF ARGUMENT

The Illinois Department of Revenue (the “Department”) seeks to collect \$2.2 million in late payment penalties assessed against PepsiCo, Inc. and Affiliates (“PepsiCo”) in connection with PepsiCo’s exclusion of Frito-Lay North America, Inc. (“FLNA”) from its Illinois unitary combined group as an “80/20 Company” during the 2011 through 2013 tax years (the “Tax Years at Issue”). The Department’s penalty assessment is unwarranted and must be abated for reasonable cause. PepsiCo made a good faith effort to determine its proper Illinois income tax liability during the Tax Years at Issue. PepsiCo has an excellent compliance history with regard to its Illinois tax obligations generally and with respect to the classification of 80/20 Companies specifically. Further, with respect to the classification of FLNA as an 80/20 Company, there is no dispute regarding the amounts reported by FLNA as property and payroll for purposes of the calculation. Rather, the dispute regarding FLNA is a “good faith” legal dispute related to the treatment of the expatriate payroll as “compensation” / “wages” paid to “employees” for 80/20 Company purposes. This issue ultimately turns on a federal common law employer-employee analysis, which the Illinois 80/20 Rule expressly incorporates by reference.

In evaluating the “80/20 Rule,” PepsiCo exercised ordinary business care and prudence by investigating the mechanics of the law, both Illinois and federal, applicable regulations, and interpretative authorities and case law -- all in accordance with the company’s best practice and procedure requirements. In doing so, the PepsiCo tax department consulted with, and relied upon, subject matter experts in expatriate global mobility and U.S. employment tax laws to ensure that payroll reported by PepsiCo Global Mobility, LLC (“PGM LLC”), a single member limited liability company (“SMLLC”) and division of FLNA, was properly classified as common law employer-employee “compensation” pursuant to Illinois statutes, the Department’s regulations, and referenced federal authorities. As such, any liability resulting from PepsiCo’s exclusion of FLNA from its combined return is the result of reasonable cause and the Department’s penalty assessment must be abated.

PROCEDURAL POSTURE

The Department issued four Notices of Deficiency (the “Notices”) to PepsiCo for the 2010 through 2013 tax years. Each of the Notices contained “UPIA-5 late-payment penalties.” PepsiCo protested the penalties on the basis of “reasonable cause” (Case No. 16 TT 82 - Count X and Case No. 17 TT 16 - Count XV).

PepsiCo and the Department have conferred and agreed in principle to settle all counts in connection with the above-captioned matters with the exception of: i) the classification of FLNA as an 80/20 Company (Count I of Case No. 16 TT 82 and Count I of Case No. 17 TT 16); and ii) PepsiCo’s “reasonable cause” penalty abatement claims (Count X of Case No. 16 TT 82 and Count XV of Case No. 17 TT 16). The Illinois Independent Tax Tribunal (the “Tax Tribunal”) has previously issued a decision regarding the classification of FLNA as an 80/20

Company.¹ Further, with respect to PepsiCo’s “reasonable cause” penalty abatement claims, the Department has agreed to waive all penalties in connection with these matters with the exception of penalties imposed on adjustments and resulting tax assessments attributable to the classification of FLNA as an 80/20 Company. As a result, this Motion for Summary Judgment relates solely to PepsiCo’s claim for “reasonable cause” abatement of penalties imposed on adjustments related to the classification of FLNA as an 80/20 Company for the 2011-2013 tax years.

SUMMARY JUDGMENT IS APPROPRIATE

Summary judgment is proper when “the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” 735 ILCS 5/2-1005(c). To this end, “summary judgment is appropriate when there is no dispute as to any material fact but only as to the legal effect of the facts.” *Dockery v. Ortiz*, 185 Ill. App. 3d 296, 304 (2nd Dist. 1989). With regard to Count X of Case No. 16 TT 82 and Count XV of Case No. 17 TT, there are no issues of material fact for the Tax Years at Issue. The Joint Stipulations of Fact (Jan. 17, 2020) and the Certification of Charles F. Mueller (Mar. 17, 2022) set forth all material facts in connection with the FLNA 80/20 Company penalty dispute.² The only remaining question is the legal effect of those facts. Accordingly, summary judgment is appropriate. For the reasons set forth herein, any Illinois tax deficiency related to PepsiCo’s classification of FLNA as an 80/20 Company was due to reasonable cause and thus penalties shall not apply.

¹ Tax Tribunal decision issued April 13, 2021.

² The Certification of Charles F. Mueller is attached hereto as **Exhibit A**.

ILLINOIS REASONABLE CAUSE PENALTY ABATEMENT AUTHORITIES

Pursuant to the Uniform Penalty and Interest Act (“UPIA”), “[a] penalty [up to 20% of the amount of tax assessed] shall be imposed for failure to pay, prior to the due date for payment, any amount of tax the payment of which is required to be made prior to the filing of a return or without a return (penalty for late payment or nonpayment of estimated or accelerated tax).” 35 ILCS 735/3-3(b-20)(2). However, Illinois law expressly provides that penalties shall not apply if the taxpayer shows that failure to pay the tax was due to reasonable cause. *See* 35 ILCS 735/3-8 (“Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department.”).

Determinations regarding reasonable cause late payment penalty abatement are made “on a case by case basis taking into account all pertinent facts and circumstances.” 86 Ill. Admin. Code § 700.400(b). To this end, “[t]he *most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine the proper tax liability and to file returns and pay the proper liability in a timely fashion.*” *Id.* (emphasis added). The taxpayer’s history of compliance is a major factor for consideration in determining whether the taxpayer acted in good faith. *See* 86 Ill. Admin. Code § 700.400(d). The Department’s regulation further provides that “[a] taxpayer will be considered to have made a *good faith effort* to determine and file and pay the proper tax liability if the taxpayer exercised *ordinary business care and prudence* in doing so.” 86 Ill. Admin. Code § 700.400(c) (emphasis added). Determining whether a taxpayer exercised ordinary business care and prudence is primarily dependent upon “the clarity of the law or its interpretation.” *Id.* To this end, Illinois case law “that supports the taxpayer’s position will ordinarily provide a basis for a reasonable cause determination.” 86 Ill. Admin. Code § 700.400(e)(8). Further, reliance on the advice of a

professional also serves as evidence that the taxpayer exercised ordinary business care and prudence. *See* 86 Ill. Admin. Code § 700.400(c) and IL - Audit Manual, Chapters 01 & 02: General Audit Information (2017) (stating reasonable cause may exist to the extent the taxpayer relied “upon the erroneous advice of a competent tax adviser.”).

The Department’s audit manual provides further detail / context regarding good faith and ordinary business care and prudence. More specifically:

good faith commonly refers to an honest belief void of any knowledge that would put a taxpayer on notice to inquire further as to his or her tax responsibilities, coupled with the absence of any intention to commit fraud.

ordinary business care and prudence ... generally means the amount of care that a reasonably logical person would take under similar circumstances, given the knowledge, experience and sophistication of the taxpayer.

IL - Audit Manual, Chapters 01 & 02: General Audit Information (2017) (emphasis in the original).

In accordance with the Department’s regulation, Illinois courts have reversed the Department’s penalty assessment for reasonable cause. Most significantly, in *Horsehead Corp. v. Ill. Dept. of Revenue*, the Illinois Supreme Court abated “late filing and payment penalties” relying on the following criteria: good faith effort through good conduct; lack of any specific statutory guidance; lack of governing case law; and the severity of the penalty in light of the foregoing factors. *See Horsehead*, 2019 IL 124155 at ¶¶ 50-51 (emphasis added) (internal citations omitted); *see also Security Life of Denver Insurance Company v. Ill. Dept. of Revenue*, 14 TT 89 (Tax Tribunal, Apr. 11, 2016) (where the Tax Tribunal determined that “[p]enalties are not imposed where a taxpayer is unable to ascertain a clear legal standard through no fault of its own.” *Id.* (emphasis added) (internal citations omitted)).

PENALTIES MUST BE ABATED FOR REASONABLE CAUSE

Reasonable cause penalty abatement is warranted in connection with PepsiCo's exclusion of FLNA from the Illinois combined group as an 80/20 Company for the following reasons: First, PepsiCo made a "good faith effort" to accurately report its Illinois tax liability for the 2011 - 2013 tax years. PepsiCo has an excellent compliance record with all of its Illinois tax obligations generally and with respect to the classification of 80/20 Companies specifically. Further, PepsiCo exercised ordinary business care and prudence in computing its Illinois income tax liability by thoroughly investigating the applicable law, both Illinois and federal, related to the 80/20 Company Rule and relying on advice of professionals. PepsiCo's classification of FLNA as an 80/20 Company was based upon and supported by applicable law and authorities addressing the 80/20 Company Rule generally, as well as the treatment of the expatriate payroll of PGM LLC as "compensation" for purposes of the 80/20 Company calculation under applicable Illinois and federal law / authorities. Also, PepsiCo consulted with, and relied upon, subject matter experts and other professionals in its classification of FLNA as an 80/20 Company, and the resulting computation of its Illinois tax liability.

I. PepsiCo's Strong Compliance Record Evidences Its Good Faith Efforts

PepsiCo invests significant resources into building a world-class tax department, capable of handling complex U.S. federal, state / local, and international tax compliance requirements. C. Mueller Certification, ¶ 11. PepsiCo's tax department is comprised of approximately 130 individuals, including accountants and attorneys who are well-versed in tax laws and corresponding compliance requirements. C. Mueller Certification, ¶ 12.

In response to its enormous tax compliance obligations, PepsiCo's tax department implements best business practices and procedures to ensure that its tax department properly

prepares and timely files all required returns and timely remits any taxes shown due thereon. C. Mueller Certification, ¶ 14. PepsiCo's best practices consist of specific processes and procedures, including: comprehensive software specially designed / customized for PepsiCo's multistate business operations; tax accountants who prepare schedules and tax returns; managers and directors who review the returns, relevant authorities, tax treatment of various items, positions, workpapers and supporting schedules; and final review and execution by an authorized tax officer (e.g., the Vice President of State and Local Tax). See C. Mueller Certification, ¶ 15.

By adhering to these best practices and procedures, and despite the immense complexity involved with each of its Illinois corporate income tax returns, PepsiCo maintained an excellent compliance record with the Department. C. Mueller Certification, ¶ 16. As a result, PepsiCo has never been assessed negligence penalties (35 ILCS 735/3-5) or fraud penalties (35 ILCS 735/3-6), as provided under the UPIA, for any tax type. C. Mueller Certification, ¶ 27. Prior to the 2010 - 2013 tax years, any issues regarding PepsiCo's Illinois income tax liability were minor discrepancies which were routinely resolved within the informal audit process. C. Mueller Certification, ¶ 26.

With specific relevance to this matter, in addition to FLNA, PepsiCo has multiple other affiliates that are classified as 80/20 Companies for Illinois tax purposes. During the 2011-2013 tax years, such entities included: Beverage Services, Inc., Pepsi Puerto Rico, Inc., Gatorade Puerto Rico Company, Quaker Oats Asia, Inc., General Bottlers of Hungary, Inc., among others. See C. Mueller Certification, ¶ 23. Other than the present dispute involving FLNA, Illinois has never made any adjustment or assessment related to PepsiCo's classification of an affiliate as an 80/20 Company. C. Mueller Certification, ¶ 24.

PepsiCo's good faith and strong compliance history is further evidenced by the fact that

there was no dispute regarding the underlying amounts of property and payroll reported on PepsiCo's books and records and utilized for purposes of FLNA's 80/20 calculation. The Department raised no objection to the amounts of property or payroll reflected in FLNA's 80/20 calculation for each of the 2011 - 2013 tax years. *See* Joint Stip. ¶ 146. In fact, the Department reviewed and expressly agreed "*as to the completeness and accuracy of the dollar amounts reported for PGM LLC.*" *Id.* (emphasis added). As a result, the dispute between the parties relates solely to a "good faith" legal dispute regarding the interpretation of applicable law, both Illinois and federal, and whether expatriate employee payroll "constitutes PGM LLC's 'compensation' or 'wages' for purposes of the 80/20 company computations under 35 ILCS 5/1501(a)(27)." *Id.* For this reason alone, penalties should be abated for reasonable cause. *See* 86 Ill. Admin. Code § 700.400(b) ("The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a *good faith effort to determine the proper tax liability* and to file returns and pay the proper liability *in a timely fashion.*" (emphasis added)).

II. PepsiCo Exercised Ordinary Business Care And Prudence In Classifying FLNA As An 80/20 Company Based Upon Illinois Law and Existing Interpretations

Prior to excluding FLNA from the Illinois combined group for the 2011- 2013 tax years, PepsiCo made a "good faith effort" to investigate the mechanics of the Illinois 80/20 Rule and evaluate corresponding 80/20 Company case law. PepsiCo's 80/20 calculation and exclusion of FLNA was consistent with Illinois law and existing interpretations. Nothing in the law or interpretations would have alerted PepsiCo to alter its 80/20 calculations or exclusion of FLNA.

A. PepsiCo's Tax Department Investigated Illinois's 80/20 Company Statute In Accordance With Its Best Business Practice and Procedure Requirements

By statute, 80/20 Companies are excluded from the Illinois combined return. *See* 35 ILCS 5/1501(a)(27)(A). An entity's qualification as an Illinois 80/20 Company is determined through

straight-forward, mechanical measurements involving the property and payroll factors. *See id.* and Ill. Admin. Code tit. 86, § 100.9700(c)(2)(B). In creating the Illinois 80/20 Company regime, the Illinois legislature sought to “provide the *certainty and stability* so important to businesses” for determining which of their affiliates are included or excluded from the Illinois combined group and resulting Illinois tax liabilities. *See* Letter from Governor James R. Thompson to the Illinois House of Representatives regarding House Bill 2588 (1982) (emphasis added). By design, the Illinois 80/20 test is evaluated by applying the clear property and payroll computations set forth in Illinois’s statutes and restated in the Department’s own regulations.

As noted above, PepsiCo’s tax department utilizes various best business practices and procedures for purposes of preparing and filing its corporate income tax returns. *See* C. Mueller Certification, ¶ 14. The FLNA 80/20 analysis was done in accordance with the tax department’s procedures and protocols. More specifically, senior members of PepsiCo’s tax department, including Charles F. Mueller (Senior Director of State and Local Tax) and Bruce Hunton (Senior Tax Counsel), analyzed Illinois’s 80/20 Rule as applied to the applicable facts. C. Mueller Certification, ¶¶ 68-69. Through this investigation, PepsiCo’s tax department “determined the technical terms of the tax law were satisfied” and precisely computed the exact property and payroll measurements as required under the law (and as expressly agreed to by the Department). *See* C. Mueller Certification, ¶¶ 61, 65. As a result, the tax department concluded that FLNA was an 80/20 Company under Illinois law and thus must be excluded from the Illinois combined group. *Id.* PepsiCo’s tax department also sought the advice and confirmation of outside state tax advisors regarding its classification of FLNA as an 80/20 Company under Illinois law. C. Mueller Certification, ¶¶ 70-71. PepsiCo’s actions here clearly reflect reasonable cause under the Department’s regulation. 86 Ill. Admin. Code § 700.400(c) (“[R]eliance on the advice of a

professional” is a factor for considering reasonable cause penalty abatement.); and IL - Audit Manual, Chapters 01 & 02: General Audit Information (2017) (“[O]rdinary business care and prudence ... generally means the amount of care that a reasonably logical person would take under similar circumstances ...” (emphasis in the original)).

B. The Illinois Appellate Court’s Decision In *Zebra Tech. Corp. v. Ill. Dept. of Revenue* Supports PepsiCo’s Classification of FLNA As An 80/20 Company

One of the few decisions addressing the Illinois 80/20 Rule at the time of filing the 2011 – 2013 returns was *Zebra Technologies Corp. v. Ill. Dept. of Revenue*, 344 Ill. App. 3d 474 (1st Dist. 2003). The PepsiCo tax department evaluated *Zebra* as part of its process of preparing its 2011 IL-1120. See C. Mueller Certification, ¶¶ 63-67. In *Zebra*, the Illinois Appellate Court rejected the taxpayer’s claim that two Bermuda intellectual property holding companies were 80/20 Companies under Illinois law. *Zebra*, 344 Ill. App. 3d at 478. More specifically, the court determined that foreign property and payroll consisting entirely of rented office space, \$1,000 for a computer, and a part-time employee making \$600/month performing only “ministerial” duties and admittedly “had no experience in managing intellectual property, trademark rights or patents” was insufficient to satisfy the 80/20 Company test. *Id.* at 477, 485. The court’s decision relied heavily on the fact that “a considerable amount of business activity relating to the development, protection and quality control of the intellectual property took place within the United States”; however, no U.S. property or payroll were reported by the intellectual property holding companies related to these substantive and required business activities. *Id.* at 484. Given that the taxpayer’s 80/20 Company calculation failed to include all of the substantive activities related to intellectual property holding companies, the court rejected the taxpayer’s claim. *Id.* at 485.

Unlike the entities at issue in *Zebra*, FLNA conducts extensive business operations in its own right, as well as through its various SMLLCs / divisions. These extensive operations are

conducted both within and outside the U.S. and include: management of the snack-foods business (e.g., setting objectives for sales growth and new product development); manufacturing, producing, bottling, and distributing soft drink products in Spain, intercompany stewardship services (e.g., business strategy, accounting, and marketing) to support PepsiCo's Asia Pacific region; supply chain distribution support; management and support functions for expatriates seconded outside the U.S.; etc. See Joint Stip. ¶¶ 10-39. In stark contrast to the minimal amounts of property and payroll reported by the entities involved in *Zebra*, FLNA had total property in excess of \$75 million and payroll in excess of \$185 million. See C. Mueller Certification, ¶ 65 and Joint Stip., Exhibits 35-37 (PEP00002873-2875). As stated above, the Department expressly agrees to the completeness and accuracy of FLNA's property and payroll amounts included in the 80/20 calculation. Joint Stip. ¶¶ 146-147.

FLNA and each of its SMLLCs / divisions listed above constitute "a single corporation" for purposes of the IITA, including for purposes of calculating FLNA's aggregate property and payroll factors for 80/20 purposes and, by extension, PepsiCo's determination that FLNA qualified as an 80/20 Company. See Ill. Admin. Code tit. 86, § 100.9750(b)(1)(A). Pursuant to the court's decision in *Zebra*, an entity's entire substantive business activity must be included as part of the 80/20 calculation. See *Zebra*, 344 Ill. App. 3d at 483-485. Neither taxpayers, nor the Department, are allowed to "cherry pick" activities for purposes of the 80/20 calculation in an effort to achieve a particular result. *Id.* Rather, pursuant to *Zebra*, all substantial / required business activities are to be included in the calculation and the resulting percentage informs / controls whether the entity is (or is not) an 80/20 Company.

As noted above, the Department's regulation expressly provides that an Illinois appellate court decision that supports the taxpayer's position "will ordinarily provide a basis for reasonable

cause determination.” Ill. Admin. Code tit. 86, § 700.400(e)(8). As discussed in greater detail below, given the stated business purpose of PGM LLC, and the advice provided to the PepsiCo tax department from subject matter experts in expatriate global mobility and federal employment tax matters, the inclusion of PGM LLC and the expatriate payroll in the 80/20 Company calculation was not only fully supported -- but was required -- by *Zebra*.

In fact, the Tax Tribunal’s April 13, 2021 determination on the FLNA 80/20 Company Issue is the first case to exclude business activities / factors for Illinois 80/20 Company purposes. While PepsiCo firmly believes FLNA qualified as an 80/20 Company under Illinois law, at worst, “[p]enalties [should] not [be] imposed where a taxpayer is unable to ascertain a clear legal standard through no fault of its own.” *Security Life of Denver*, 14 TT 89; *see also Horsehead*, 2019 IL 124155 at ¶ 51 (“there was no case law that Horsehead could have turned to for guidance ...”). Based upon the facts and advice provided at the time PepsiCo filed its Form IL-1120 returns for the 2011 - 2013 tax years, there was nothing in Illinois law or the Department’s administrative guidance that would have required or alerted PepsiCo to exclude PGM LLC and the expatriate payroll from FLNA’s 80/20 calculation.

Finally, it is important to note that the Department did not assert penalties in *Zebra* despite the taxpayer’s attempt to satisfy the 80/20 Company test by excluding the factors attributable to substantive U.S. business operations and inserting nominal amounts of “foreign” property and payroll attributable to shared office space / computer and a single part-time employee performing ministerial duties. *See Zebra*, 344 Ill. App. 3d at 480 (“***The Department did not impose any penalties ...***” (emphasis added)). Comparing the facts in the present case to those in *Zebra*, the Department’s refusal to abate penalties here violates the Illinois equal protection clause and is an abuse of discretion. *See ILL. CONST.* art. 1, § 2.

III. PepsiCo Exercised Ordinary Business Care and Prudence When It Included PGM LLC's Payroll as "Compensation" for Purposes of Illinois's 80/20 Rule

As detailed above, the 80/20 Rule requires straight-forward, mechanical measurements of property and payroll. For 80/20 Rule purposes, payroll is measured by "compensation" or "wages" as provided under federal law. Consistent with Illinois law, PepsiCo's tax department included all amounts treated as "wages" for federal purposes as "compensation" / payroll for Illinois 80/20 purposes. The federal determination / classification of PGM LLC's expatriate payroll was done by subject matter experts with extensive knowledge and practical experience in expatriate global mobility and U.S. employment tax matters. Further, the classification of the expatriate compensation as PGM LLC's payroll / "wages" for federal purposes is consistent with controlling federal employment tax authorities and U.S. Supreme Court precedent, which are expressly incorporated into Illinois's 80/20 Rule.

A. PepsiCo Reasonably Considered All of PGM LLC's Payroll as "Compensation" for Purposes of Illinois's 80/20 Rule

The Illinois 80/20 Rule is evaluated by applying the clear property and payroll computations set forth in Illinois's statutes and restated in the Department's own regulations. To calculate payroll, taxpayers must determine the amount of "compensation paid" during the year, which, in turn, "mean[s] wages, salaries, commissions and any other form of remuneration *paid to employees* for personal services. ***The term is thus the same as the term 'wages' as used in 26 U.S.C. § 3401(a) ...***" Ill. Admin. Code tit. 86, § 100.3100(a) (emphasis added); *see also* 35 ILCS 5/304(a)(2)(A) and Ill. Admin. Code tit. 86, § 100.3360(a)(1). The term "employee" also "has the same meaning under the Illinois Income Tax Act as under 26 U.S.C. Section 3401(c) and 26 CFR 31.3401(c)-1." Ill. Admin. Code tit. 86, § 100.3100(b). Simply put, an "employee's" federal "wages" constitute "compensation" / payroll for Illinois 80/20 Rule purposes.

In this case, consistent with Illinois law and regulations, PepsiCo included all “wages” reported by PGM LLC for federal employment tax purposes as “compensation” / payroll for FLNA’s 80/20 Company calculation. *See* Joint Stip. ¶¶ 80, 112, 114-117, 122, 147 and Exhibits 27 and 28. The classification of PGM LLC’s payroll for federal employment tax purposes was determined by subject matter experts in the areas of expatriate global mobility and U.S. employment tax matters who were tasked with the responsibility for ensuring that, consistent with PGM LLC’s stated business purpose, objectives and goals, the expatriates were classified as the common law employees of PGM LLC. *See* C. Mueller Certification, ¶¶ 43, 72-74 and Joint Stip. ¶¶ 81-110.

The global mobility transformation project team advised PepsiCo’s tax department that the expatriates’ common law employment through PGM LLC (a U.S. legal entity) was required to allow continued participation in PepsiCo’s U.S. compensation scale (*i.e.*, payment of U.S. “wages” reportable on Form W-2) and, by extension, PepsiCo’s U.S. benefits plan (*e.g.*, pre-tax retirement contribution plans authorized under 26 U.S.C. § 401(k)). *See* C. Mueller Certification, ¶¶ 45, 55, 73 and Joint Stip. ¶¶ 67, 81, 82, 115, 116 and Exhibits 27 and 28. Without continuing employment through a U.S. entity, expatriates would, among other things, be required to terminate their PepsiCo U.S. compensation plans and sever critical benefits that come with employment by a U.S. entity, such as 401(k) retirement contribution plans, PepsiCo’s U.S. pension plan, etc. *See* Joint Stip. ¶¶ 67, 82.

PepsiCo’s tax department exercised “ordinary business care and prudence” by consulting with and relying upon these subject matter experts classification of the expatriates as common law employees of PGM LLC. *See* 86 Ill. Admin. Code § 700.400(c) and IL - Audit Manual, Chapters 01 & 02: General Audit Information (2017) (“**[O]rdinary business care and prudence ...**

generally means the amount of care that a reasonably logical person would take under similar circumstances ...”). As a result of this investigation and professional advice, the PepsiCo tax department honestly -- and with good reason -- believed PGM LLC’s federal expatriate payroll was required to be included as “compensation” for Illinois payroll measurement purposes for business reasons completely independent of, and unrelated to, any impact on the Illinois 80/20 Rule. *See* 86 Ill. Admin. Code § 700.400(c) (“[R]eliance on the advice of a professional” is a factor for considering reasonable cause penalty abatement) and IL - Audit Manual, Chapters 01 & 02: General Audit Information (2017) (“[G]ood faith commonly refers to an honest belief void of any knowledge that would put a taxpayer on notice to inquire further as to his or her tax responsibilities, coupled with the absence of any intention to commit fraud.”).

B. The Subject Matter Experts’ Advice and Treatment of PGM LLC as the Common Law Employer Is Consistent with Federal Law

As noted above, the sole dispute regarding FLNA’s classification as an 80/20 Company is a “good faith” legal dispute related to the treatment of the expatriate payroll as “compensation” / “wages” paid to “employees” for 80/20 Company purposes. This issue ultimately turns on a federal common law employer-employee analysis, which the Illinois 80/20 Rule incorporates by reference. Consistent with PGM LLC’s stated business purpose, goals, and objectives -- and without regard to any Illinois corporate tax implications -- PepsiCo’s global mobility project transformation team intentionally structured the PGM LLC employment contracts and secondment agreements to ensure that PGM LLC was the common law employer of each of its expatriates throughout the duration of their temporary assignment / secondment abroad. *See* C. Mueller Certification, ¶¶ 44-45, 50-54, 73-74 and Joint Stip. ¶¶ 63-64, 83-84. These contracts and agreements are consistent with federal authorities defining common law employer-employee relationships.

For example, consistent with applicable federal authorities, the PGM LLC secondment agreements and contracts of employment were structured to ensure PGM LLC retained the right to direct and control the expatriates as the common law employer, even if day-to-day supervision / control was ceded to the foreign host companies. *See* Treas. Reg. § 31.3401(c)-1(b) (“***it is not necessary that the employer actually direct or control the manner in which services are performed; it is sufficient if he has the right to do so.***”) (emphasis added); *see also* C. Mueller Certification, ¶¶ 44-45, 50-54 and Joint Stip. ¶¶ 83, 84. In this regard, common law employer-employee relationships, as defined by Treas. Reg. § 31.3401(c)-1(b), are intentionally clear for practical use by businesses operating in the real world. Upholding this principle, the U.S. Supreme Court has held that employer-employee determinations are governed by agency principles without regard to the declared policy or purpose of a statute’s use of the word “employee” or “compensation” / “wages.” *See Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992). Common law employer-employee determinations are intended to be straight-forward agency determinations for practical use by businesses without forcing them to consider amorphous and tenuous considerations of the policy and/or purpose of an underlying statute, such as the Illinois 80/20 Rule. As a result, “[i]n determining the parties’ relationship in the *Darden* context, [courts] have several times ‘***look[ed] to any express agreement between the parties as to their status as it is the best evidence of their intent’ and placed great weight on that agreement.***” *Jammal v. Am. Family Ins. Co.*, 914 F.3d 449, 459 (6th Cir. 2019) (emphasis added).

As evidenced by this case, one might dispute the classification of the expatriates as common law employees of PGM LLC after the fact. However, given PGM LLC’s stated business purpose, objective and goals, along with the binding legal agreements, PepsiCo’s classification of the expatriates as common law employees of PGM LLC was consistent with the applicable federal

authorities and completely reasonable. More importantly, there is nothing in federal / Illinois guidance that would have alerted PepsiCo's tax department to a different conclusion when it determined FLNA was an 80/20 Company for Illinois income tax purposes. *See Horsehead*, 2019 IL 124155 at ¶¶ 50-51.

CONCLUSION

Viewed in totality, PepsiCo acted with reasonable cause and in good faith in determining that FLNA was an 80/20 Company properly excluded from the Illinois combined group during the 2011 - 2013 tax years. PepsiCo has a history of strong compliance with Illinois. With ordinary business care and prudence, PepsiCo aggregated all of FLNA's substantive business activities and precisely calculated 80% or more of FLNA's property and payroll was outside of the U.S. in accordance with Illinois's clearly defined and mechanical 80/20 Rule, which expressly incorporates federal law to determine the amount of "compensation" / "wages" to be included as 80/20 payroll. In making its classification, PepsiCo's tax department relied upon the advice of professionals in the form of subject matter experts in the areas of global employment and U.S. employment tax law in support of its inclusion of PGM LLC and the expatriates' payroll in the 80/20 Company calculation. Additionally, PepsiCo sought advice and obtained confirmation of its determination that FLNA was an 80/20 Company under Illinois law from outside tax advisers, prior to taking any formal return position.

For the reasons set forth in this memorandum, any Illinois tax liability resulting from PepsiCo's exclusion of FLNA from its unitary combined returns as an 80/20 Company for the Tax Years at Issue was due to reasonable cause and thus UPIA penalties shall not apply. Summary Judgment in PepsiCo's favor is proper on County X of Case No. 16 TT 82 and Count XV of Case No. 17 TT 16. The Department's assessment of penalties must be abated in full.

Respectfully submitted,

PepsiCo, Inc. and Affiliates

Dated: March 17, 2022

By: /s/ Theodore R. Bots
Attorney for Petitioner

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EXHIBIT A

IN THE ILLINOIS INDEPENDENT TAX TRIBUNAL

PEPSICO, INC. AND AFFILIATES,)	
)	Case Nos. 16 TT 82 and 17 TT 16
Petitioner,)	
)	
v.)	
)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE,)	
)	
Respondent.)	

CERTIFICATION OF CHARLES F. MUELLER

1. I was employed by PepsiCo, Inc. (“PepsiCo”), or a related affiliate, for 35 years, 9 months.
2. My positions at PepsiCo included: Senior Director of State and Local Tax (from August 2002 to January 2012); and Vice President of State and Local Tax (from January 2012 to May 2021).
3. I graduated from Providence College in 1978 with a Bachelor of Science in Accounting.
4. During my tenure at PepsiCo, I actively participated in various non-profit tax organizations, including as a member of the Council On State Taxation (“COST”) and as a member of the Advisory Board for the National Multistate Tax Symposium where I also frequently presented on national state / local tax trends and developments.
5. Unless otherwise stated, I have personal knowledge with respect to the matters set forth below.
6. Where I use the phrase, “on information and belief,” I do not have personal knowledge on that point but -- based on my long tenure with PepsiCo and my conversations with colleagues -- I firmly believe that point to be true and have taken all reasonable steps to confirm that it is true.

7. If called as a witness in connection with this matter, I would testify in a manner consistent with the statements set forth below.

The PepsiCo Corporate Group

8. PepsiCo, Inc. is a publicly-traded corporation duly organized and existing under the laws of North Carolina.
9. PepsiCo, Inc.'s corporate headquarters are located at 700 Anderson Hill Road, Purchase, New York, 10577.
10. PepsiCo, Inc. and its world-wide affiliates (hereinafter, the "PepsiCo Corporate Group") manufactures, markets, and sells a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages and foods in approximately 200 countries, with its largest operations in North America (United States and Canada), Mexico, and the United Kingdom.

PepsiCo Invests Significant Resources Into Its State/Local Tax Compliance Obligations and Has An Excellent Tax Compliance Record with the State of Illinois

11. PepsiCo invests significant resources into building a world-class tax department, capable of handling complex U.S. federal, state / local, and international tax compliance requirements.
12. PepsiCo's tax department is comprised of approximately 130 individuals, including certified public accountants and attorneys who are well-versed in tax laws and corresponding compliance requirements.
13. Each year, PepsiCo typically prepares, files, and remits taxes related to over 23,000 total state and local returns, including over 1,000 state and local income tax returns.
14. In response to its enormous tax compliance obligations, PepsiCo's tax department implements best business practices and procedures to ensure that its tax department properly prepares and timely files all required returns and timely remits any taxes shown due thereon.

15. For corporate income tax purposes, PepsiCo's best business practices require the following processes and procedures:

- CorpTax, Inc. ("CorpTax") software is designed and customized for PepsiCo's multinational tax accounts.
- CorpTax software allows PepsiCo's tax department personnel to collect, compile, and process data necessary to prepare and file U.S. federal income tax returns and state / local income, franchise, and gross receipts tax returns.
- PepsiCo tax department personnel utilize CorpTax software to prepare state income tax return schedules, which are used to: validate apportionment data, identify state factors, determine state filing requirements based on nexus reports, determine state filing status (*e.g.*, separate, combined, unitary), calculate state-specific adjustments, identify and apply all tax return estimated payments, credits, and extension payments, etc.
- PepsiCo tax managers and senior directors work with others in the PepsiCo tax department to review the tax return schedules, correct errors, and advise on required changes.
- After the state tax data collection process is complete, and corresponding tax return schedules finalized, personnel from the PepsiCo tax department prepare the state income tax returns.
- After the draft tax returns are prepared, PepsiCo tax compliance managers and/or tax directors review the returns in detail, including relevant authorities, positions taken, supporting schedules and underlying calculations.

- After the requisite approvals are obtained, and the draft tax returns are finalized, the returns are again reviewed by a corporate officer (*e.g.*, Vice President of State and Local Tax) and executed for filing with the applicable taxing jurisdiction.
16. By adhering to these practices and procedures, PepsiCo had an excellent compliance record with the State of Illinois for corporate income tax purposes throughout the duration of my tenure as Senior Director and then as Vice President of State and Local Tax.
 17. Throughout the duration of my tenure at PepsiCo, similar best practice processes and procedures were implemented in connection with PepsiCo's other state / local tax reporting obligations, *e.g.*, the retailers' occupation tax, use tax, etc.
 18. As with the corporate income tax, by adhering to these practices and procedures, PepsiCo had an excellent compliance record with the State of Illinois in connection with all its non-income tax filing obligations throughout the duration of my tenure as Senior Director and then as Vice President of State and Local Tax.
 19. With respect to the Illinois corporate income tax, PepsiCo is routinely audited by the Illinois Department of Revenue (the "Department") to determine the proper tax owed to the State.
 20. PepsiCo's tax department has developed a cordial and professional relationship with the Department's auditors over the years, including providing timely responses to information document requests and access to corporate records both onsite at PepsiCo's corporate offices and remotely.
 21. For each of the 2010 through 2013 tax years, PepsiCo timely filed Form IL-1120, "Corporation Income and Replacement Tax Return."
 22. PepsiCo's unitary combined Illinois corporate income tax return is extraordinarily complex, including during each of the 2010 - 2013 tax years, consisting of approximately: 150 entities;

\$40 billion in gross receipts; over \$1 million of earned income tax credits (*e.g.*, Edge Tax Credits, R&D Tax Credits, Investment Tax Credits, etc.); entities with unique Illinois apportionment requirements (*e.g.*, transportation companies, manufacturers, insurers, etc.), distributions from partnerships; complex entity-by-entity schedules (*e.g.*, Schedule 80/20 Related-Party Expenses); etc.

23. Further, numerous PepsiCo affiliates were classified as 80/20 Companies for Illinois corporate income tax purposes. The following is a listing of affiliates and the years in which they were qualified as 80/20 Companies for Illinois tax purposes.

PepsiCo's Affiliated - 80/20 Companies	Tax Years Qualified
<i>Beverage Services, Inc.</i>	2006-2013
<i>Beverages, Foods & Service Industries, Inc.</i>	2006-2010
<i>PepsiCo World Trading Company, Inc.</i>	2006-2009
<i>Long Bay, Inc.</i>	2006-2010
<i>Stokley-Van Camp, Inc.</i>	2006-2007
<i>Gatorade Puerto Rico Company</i>	2006-2013
<i>Quaker Oats Europe, Inc.</i>	2006-2010, 2012-2013
<i>Quaker Oats Asia, Inc.</i>	2006-2013
<i>PepsiCo (Malaysia) Sdn. Bhd. Co.</i>	2006-2013
<i>Pepsico Puerto Rico, Inc.</i>	2006-2013
<i>General Bottlers of Hungary, Inc.</i>	2010-2013
<i>Frito Lay North America, Inc.</i>	2011-2013

24. Other than the present dispute involving Frito Lay North America, Inc., Illinois never made any audit adjustments or assessments related to PepsiCo's classification of an affiliate as an 80/20 Company.

25. Despite the immense complexity involved with each of its Illinois corporate income tax returns, PepsiCo maintained an excellent compliance record by accurately filing its Illinois corporate income tax returns in general and with respect to its classification of 80/20 Companies specifically.

26. Prior to the 2010 to 2013 tax years, any issues regarding PepsiCo's Illinois income tax liability were minor discrepancies which were routinely resolved within the informal audit process.
27. During my tenure, PepsiCo was never assessed negligence penalties (35 ILCS 735/3-5) or fraud penalties (35 ILCS 735/3-6), as provided under the Uniform Penalty and Interest Act, for any tax type.

Formation of PepsiCo Global Mobility, LLC During PepsiCo's 2010 Global Restructuring

28. On February 26, 2010, PepsiCo acquired two unrelated businesses -- i) The Pepsi Bottling Group and affiliated entities ("PBG"); and ii) PepsiAmericas, Inc. and affiliated entities ("PAS").
29. Prior to their acquisition by PepsiCo, PBG and PAS were the two largest publicly traded independent bottlers of Pepsi products.
30. The PBG and PAS acquisitions reduced third-party costs for PepsiCo by eliminating transactions between concentrate manufacturers within the PepsiCo Corporate Group and third-party bottlers outside the PepsiCo Corporate Group.
31. At the time of their acquisition, PBG and PAS together employed more than 84,000 people, and the entities collectively owned more than \$18 billion in assets to carry on their bottling and distribution operations.
32. As a result of the PBG and PAS acquisitions, 67 domestic and 119 international entities were integrated into the PepsiCo Corporate Group's overall corporate structure.
33. At the time of the acquisitions, the PepsiCo Corporate Group, PBG, and PAS each utilized respectively the following separate entities for their foreign expatriate programs: Beverages

Foods & Services Inc. (for the PepsiCo Corporate Group), C&I Leasing, Inc. (for PBG), and Pepsi-Cola General Bottlers, Inc. (for PAS).

34. The acquisitions of PBG and PAS resulted in approximately 200 U.S. / foreign national expatriates within the PepsiCo Corporate Group being scattered across various PepsiCo affiliates and seconded outside the U.S. to serve the various businesses of the PepsiCo Corporate Group as part of the then existing expatriate programs.
35. PepsiCo Global Mobility, LLC (“PGM LLC”) was formed on June 23, 2010 under Delaware law as an LLC wholly owned by and treated as disregarded entity / division of Frito-Lay North America, Inc. for both federal and Illinois state income tax purposes.
36. After PGM LLC’s formation, the PepsiCo Corporate Group utilized PGM LLC as the single expatriate program entity for foreign-based (non-U.S.) secondments.
37. At the time of, and in connection with, the PepsiCo Corporate Group’s 2010 global restructuring, PricewaterhouseCoopers (“PwC”) assessed the PepsiCo Corporate Group’s overall global mobility practices.
38. PwC identified the following areas of improvement for the PepsiCo Corporate Group’s global mobility practices: 1) “G[lobal] M[obility] function and processes do not align with the business strategy”; 2) “Service delivery model is not in line with ‘best practice’”; 3) “Significant duplication of effort across the function & opportunities to streamline, automate & remove non-value added work”; 4) “Inconsistency in services across countries and regions”; and 5) “Lack of career progression/opportunities within the team.” *See* Joint Stipulation of Facts (Jan. 17, 2020) (“Joint Stip.”), Exhibit 17 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004816)).

39. In connection with forming PGM LLC, PepsiCo formed a comprehensive global mobility transformation project team. *See* Joint Stip., Exhibit 21 (PepsiCo Global Mobility Transformation Advisory Council Update (Jul. 2011) (PEP00004879)).
40. With support from PwC, the global mobility transformation project team was comprised of at least 26 specialists from across PepsiCo's broad corporate platform, including (but not limited to): the talent development team; the compensation and benefits team; the human resources team; the transformation and control team; and the corporate tax team. *See* Joint Stip., Exhibit 17 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004827)).
41. The global mobility transformation project team was tasked with transforming PepsiCo's global mobility practices by implementing PwC's recommendations outlined above. *See* Joint Stip., Exhibit 17 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004818)).
42. PepsiCo's global mobility transformation project team sought to implement best practices in global mobility from a wide-range of business perspectives, including human resources, compensation and benefits, talent development, etc.
43. The global mobility transformation project was a non-tax / business driven exercise, as evidenced by the fact that 25 of the 26 individual subject matter experts included on the global mobility transformation project team were from various non-tax related functions of the business; only one person (Maryanne Bifulco, Senior Compensation and Benefits Counsel) specialized in employment tax matters. *See* Joint Stip., Exhibit 17 (PepsiCo Global Mobility Transformation Plan (Jan. 2011) (PEP00004818)).
44. Based upon my conversations with PepsiCo's compensation and benefits experts (including

Ms. Bifulco) prior to filing PepsiCo's Form IL-1120 in 2011, PGM LLC's secondment agreements and employment contracts were designed to ensure PGM LLC remained the common law employer of the expatriates throughout the duration of their temporary foreign secondments to related PepsiCo affiliates.

45. Further, the global mobility transformation project team determined that PGM LLC's classification as the common law employer for all non-U.S. secondments preserved the expatriates' continued participation in U.S. benefits plans for the duration of their temporary secondments abroad.
46. Consolidation of expatriate program operations from three entities into one entity eliminated duplication of effort from managing multiple expatriate program entities and streamlined global mobility processes consistent with PwC's advice and the goals of the global mobility transformation project team.
47. PGM LLC was formed as a subsidiary of FLNA for a variety of business reasons, including (but not limited to):
 - The importance of the snack-foods business to the PepsiCo Corporate Group's domestic and international business operations;
 - FLNA's historic presence in international markets through ownership of various SMLLCs / divisions operating abroad, including the GMD Branch (exportation of snack products to the Asia-Pacific and Caribbean regions since the early 1990s), PepsiCo Hong Kong, LLC (intercompany stewardship services (e.g., business strategy, accounting, and marketing) to support PepsiCo's Asia Pacific region), QFL OHQ SDN. BHD (a Malaysian Sendirian Berhad tasked with supply chain distribution support for the Asia-Pacific region), and Centro-Mediterranea de Bebidas Carbonicas PepsiCo S.L. (a Spanish Sociedad Limitada that manufactures, produces, bottles and sells soft drink products in Spain);
 - To align PGM LLC with the other foreign operations / entities organized underneath FLNA.

- FLNA’s consistent role in, and need for, sending high performing executives, managers, etc. on foreign assignments and receiving such individuals post-assignment; and
- The fact that the majority of expatriates seconded through the expatriate program either work for the snack-foods business all of the time or work partially for the snack-foods business.

Intended Business Purpose for PepsiCo Global Mobility, LLC

48. PGM LLC is a separate legal entity and is respected as such both internally within the PepsiCo Corporate Group and externally with regard to outside third-parties; however, for federal and Illinois corporate income tax purposes, PGM LLC is a single-member limited liability company (“SMLLC”) disregarded from, and treated as a division of, its owner, FLNA.
49. PGM LLC was formed to resolve operational inefficiencies related to the PepsiCo Corporate Group’s employment structure by employing all U.S. paid expatriates seconded to PepsiCo Corporate Group entities outside the U.S.
50. For each individual included on the PGM LLC payroll reports for the 2011 to 2013 tax years, PGM LLC and the applicable foreign host company executed a secondment agreement.
51. For each individual included on the PGM LLC payroll reports for the 2011 to 2013 tax years, PGM LLC and the individual executed an employment agreement (*i.e.*, a “letter of understanding”) outlining applicable terms which apply during the assignment.
52. The secondment agreements and the contracts of employment / letters of understanding were intended to be the legal basis by which the seconded expatriates perform services / roles for the foreign host companies.
53. Those agreements were created with the intent to govern the expatriates’ conduct and rights on assignment.

54. By executing each secondment agreement and employment agreement, PGM LLC was designed to be the employer of each seconded expatriate.
55. PGM LLC's classification as the employer of record of each seconded expatriate was critical to the development of PepsiCo Corporate Group's international business operations including (but not limited to) preserving expatriates' ability to participate in U.S. benefits plans.
56. PepsiCo formed PGM LLC to serve as the PepsiCo Corporate Group's single expatriate program entity to fulfill the foregoing purposes without regard to any state tax savings.
57. At the time of my retirement on May 29, 2021, PepsiCo continued to utilize PGM LLC as the employer of record of seconded expatriates outside the U.S. for the reasons outlined above, regardless of any state tax savings, including any administrative tribunal or judicial court determination regarding FLNA's qualification (or lack thereof) as an 80/20 company under Illinois law.
58. Based on information and belief, PepsiCo will continue to utilize PGM LLC as the employer of record of seconded expatriates outside the U.S. for the reasons outlined above, regardless of any state tax savings, including any administrative tribunal or judicial court determination regarding FLNA's qualification (or lack thereof) as an 80/20 company under Illinois law.

PepsiCo Believed that Frito-Lay North America, Inc. was Properly Classified as an 80/20 Company Under Illinois Law Prior to Filing Its 2011 - 2013 Illinois Corporate Income Tax Returns

59. In my roles as Senior Director and Vice President of State and Local Tax at PepsiCo, it was my role and responsibility to determine the reasonableness of all major state and local tax positions taken by PepsiCo.
60. Based on the facts set forth above, I analyzed whether FLNA qualified as an 80/20 company under Illinois law.

61. I determined that the technical terms of the tax law were satisfied because, through ownership of its various disregarded entities, including PGM LLC among others, 80% or more of FLNA's business activity was outside the United States in accordance with the Illinois Income Tax Act ("IITA"), which states: "The [unitary business] group will not include those members whose business activity outside the United States is 80% or more of any such member's total business activity ..." 35 ILCS 5/1501(a)(27)(A).
62. Before PepsiCo filed Form IL-1120 for the 2011 - 2013 tax years, I evaluated the definition of "business activity" under the IITA and the Department's regulations and determined the "mechanical" measurements of foreign business activity for purposes of the 80/20 company test are the property and payroll factors. See 35 ILCS 5/1501(a)(27)(A) and Ill. Admin. Code tit. 86, § 100.9700(c).
63. In connection with reviewing the IITA and the Department's regulations outlining the rules and requirements for 80/20 companies, and prior to filing Form IL-1120 for the 2011 to 2013 tax years, I also analyzed Illinois case law addressing the Illinois 80/20 company test, including (but not limited to) *Zebra Technologies Corp. v. Topinka*, 344 Ill. App. 3d. 474 (1st Dist. 2003).
64. Unlike the entities at issue in *Zebra*, who the taxpayer attempted to satisfy the 80/20 test by the addition of a few thousand dollars in foreign property and foreign payroll for part-time "ministerial" services, FLNA had substantive business operations, both within and without the U.S., in its own right as well as those performed by each of its SMLLCs / divisions affiliates treated as divisions of FLNA for Illinois income tax purposes, many of which were doing business outside the U.S.
65. More specifically, in contrast to the minimal amounts of property and payroll at issue in

Zebra, during the Tax Years at Issue, FLNA had total property and payroll in the following amounts: \$46,495,392 property and \$140,069,077 payroll (2011); \$71,096,798 property and \$162,190,794 payroll (2012); and \$75,927,943 property and \$185,718,229 payroll (2013). See Joint Stip., Exhibits 35-37 (PEP00002873-2875) and Joint Stip. ¶¶ 146-147 (noting the Department does not dispute the accuracy of these amounts reported).

66. Given the substantive U.S. and foreign business operations performed by FLNA, as well as each of its disregarded SMLLCs / divisions, the concerns identified by the Illinois Appellate Court in *Zebra*, were not present with respect to FLNA, and in fact, the inclusion of all of FLNA's underlying business activities in the 80/20 calculation, including PGM LLC, is fully consistent with and supported by the *Zebra* decision.
67. Consistent with *Zebra*, I determined that FLNA, through its SMLLCs / divisions, had a significant amount of property and payroll activities outside the United States during the Tax Years at Issue; although FLNA also had U.S. operations, such U.S. operations were not sufficient to cause FLNA to fail the mechanics of the 80/20 company test.
68. In addition to reviewing Illinois's 80/20 statute, regulations, and case law, I consulted with members of PepsiCo's tax department, including Bruce Hunton (State Tax Counsel at PepsiCo), prior to PepsiCo filing Form IL-1120 for the 2011 - 2013 tax years.
69. My discussions with Mr. Hunton (among other members of the PepsiCo tax department) included applying Illinois's 80/20 company rules and requirements to FLNA's direct business operations and its ownership of various disregarded entities with foreign operations, including PGM LLC.
70. In order to further confirm my conclusions, I consulted with state tax advisors regarding my view that FLNA qualified as an 80/20 company under the laws of various states, including

Illinois.

71. Specifically, prior to PepsiCo filing its 2011 Form IL-1120, advisors from PwC confirmed my view that FLNA qualified as an 80/20 company under the laws of various states, including Illinois.
72. Prior to PepsiCo filing its 2011 Form IL-1120, my investigation also included discussions with subject matter experts from PepsiCo's global mobility transformation project team who confirmed that PGM LLC is the common law employer of all expatriates seconded outside the U.S.
73. As a result of my discussions with these subject matter experts, I determined that PGM LLC had business purpose because it was formed for the specific reason of employing high-performing expatriate executives, directors, managers, and analysts from PepsiCo Corporate Group affiliates / operating companies who fulfill temporary key roles with the objective of developing and retaining talent and expanding foreign business operations in established and emerging international markets, while at the same time allowing the expatriates to remain on, and participate in, the PepsiCo Corporate Group's U.S. benefits plans (wages, salaries, bonuses, stock options, retirement plans, etc.).
74. Similarly, as a result of my discussions with these subject matter experts, I determined that PGM LLC had economic substance because it was the single legal entity used to effectuate international secondments and had to, for example, pay expatriate salaries / compensation and perform management and support functions for the expatriates through a team of human resource personnel, referred to as the "Global Mobility HR Function," who worked for PGM LLC.
75. The relationships between PGM LLC and these expatriates meaningfully changed the

positions of each party and, thus, met the requirements of a relationship or entity to have economic substance. *See Kraft Foods Co. v. Commissioner*, 232 F.2d 118, 124 (2nd Cir. 1956).

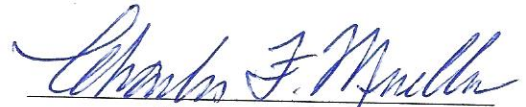
76. Based on my views of FLNA and PGM LLC, I recommended to the rest of the tax team at PepsiCo to take the reporting position that FLNA was an 80/20 company for the 2011 tax year (and each subsequent tax year to the extent it qualified under applicable law).

77. PepsiCo's determination that FLNA qualified as an 80/20 company under Illinois law was made in good faith -- and with ordinary business care and prudence -- in accordance with the PepsiCo tax department's best business practices and procedures and then going beyond those requirements by confirming with outside expert state tax advisors at PwC prior to taking any formal return position.

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Under penalties as provided by law pursuant to Section 1-109 of the Illinois Code of Civil Procedure, the undersigned certifies that the statements set forth in this instrument are true and correct to the best of my information and belief.

Dated: 3/17/2022


Charles F. Mueller

CERTIFICATE OF SERVICE

The undersigned counsel of record certifies that a copy of the **PETITIONER PEPSICO, INC. AND AFFILIATES' MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT FOR REASONABLE CAUSE PENALTY ABATEMENT** was served on March 17, 2022 to the following persons:

Judge James M. Conway Chief Administrative Law Judge Illinois Independent Tax Tribunal 160 N. LaSalle Street, Room N506 Chicago, IL 60601 James.Conway@illinois.gov	Alan V. Lindquist Illinois Department of Revenue Special Assistant Attorney General 100 W. Randolph Street, 7th Floor Chicago, IL 60601 Alan.Lindquist@illinois.gov
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